

What do board members worry about?

A frequent complaint from executives and project proponents is that, although the board are responsible for ensuring that the organisation has an appropriate risk management system and that it is implemented, when project risk is presented and discussed in the boardroom it is difficult to generate the right level of engagement. In particular the board often ask about risks that are extraneous to the project or that will not be impacted by project management.

A simple solution to this problem is to initiate the discussion with the strategic plan and explain to the board, firstly, how the project supports that plan and what are the key deliverables and, secondly, what are the risks that would threaten attainment of the plan objectives and how implementation of the project will mitigate these risks. It is then possible to create an interactive discussion with a high degree of board engagement.

When risk is considered by the board in the absence of a management developed framework the key risks that emerge from the discussion are frequently not those that would be typically encountered in a risk management system, regardless of how well it had been developed. This is not to say that either board or management are *wrong* in their assessment. It is just that they assess the issues from their own unique perspective.

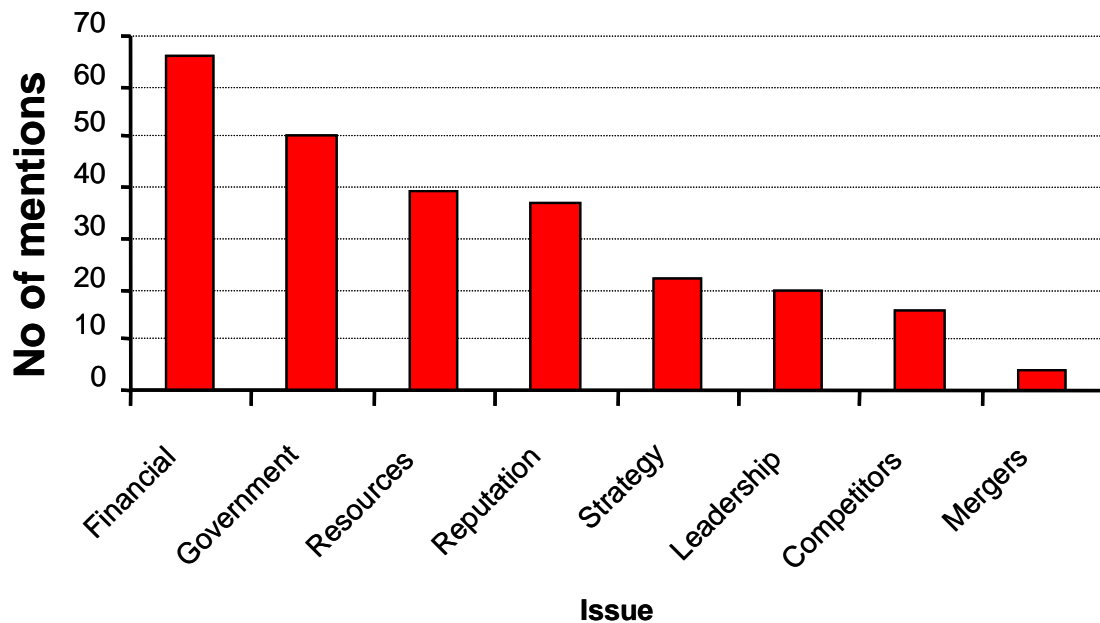
What are the key risks as perceived by the board?

From research with 241 company directors, undertaken from 2004 until 2006, the key risks as perceived by the directors were:

- Finance
- Government
- Resources
- Reputation
- Strategy
- Leadership
- Competitors, and
- Mergers or acquisitions

Of themselves, the risks in this list seem unremarkable; however, in discussion about how the key risk will manifest itself the perception differs markedly from the way in which risks of a similar name might be portrayed in a traditional project risk management system. Additionally many of the risks (such as leadership) are systematic and apply to the organisation rather than to any one specific project. Failure to mention these risks in discussion with the board can lead board members to consider that risk is not being addressed in a holistic manner.

Financial risk is rarely considered in terms of fraud or of financial statement inaccuracy. These things are embarrassing and annoying, but they are rarely 'company killers'. The key issue raised was cash flow and the need to have sufficient money at the times when it was needed. Financial performance was also mentioned, but usually only in so far as it affected the other issues. The smaller the company the more likely there would be a need to raise capital and the greater the chance that failing to do so would prevent strategic success.



Government was seen as the second most likely factor to prevent a company from achieving its strategy. In discussion, this risk was generally characterised as a risk of change in the legislative and regulatory environment. Government action is, clearly, outside the sphere of control of most companies. However, that is no excuse for failing to put in place systems for monitoring likely developments or for briefing politicians and their advisors on the implications of change. This risk is more likely to be voiced by the more experienced directors than by the younger, less experienced directors, as being the most likely cause of strategic failure.

When discussing the risk of inadequate or misapplied resources most directors went straight to the human resources of the organisation. The most common risk was a lack of human resources or lack of appropriately skilled resources at an affordable price. Another resource risk, which was frequently mentioned, was the loss of intellectual property with departing staff.

The risk of reputation damage was nearly always discussed in terms of failure to manage the reputation rather than in terms of being found to have undertaken activities, which were not acceptable to modern day society.

When discussing strategy, many directors, voiced concern that they may have simply endorsed the wrong strategy, and also, that the organisation may not have the skills required for implementation. Lack of decision-making skills at other levels in the organisation was also cited as likely to exacerbate this risk, as was poor communication of the strategy and a lack of the leadership required to drive it.

On the issue of leadership, many directors, whilst declaiming a lack of confidence in the leadership ability of management, raised the issues of change management, and also of a lack of real management support for the strategy which had been endorsed. Board members were unanimous in agreeing that if management did not really support the strategy no board could expect it to be delivered. Another frequently raised leadership issue was that of board failure. This was frequently characterised as a failure to reach consensus, which led boards to either remain in the status quo or pursue small "no regrets" actions, rather than make the bold progress which the strategy required.

When discussing the risks associated with competitor activity board members tended to mention issues and risks which would normally be expected to be covered within a traditional risk management system. These included customers switching, lack of pipeline of development products, blockage of suppliers by a more powerful competitor, and unexpected competitor actions.

As with the competition risks, the risks of mergers and acquisitions tended to be those which a normal well-managed risk management system would contain. Integration risk tended to be the key source of internal weakness, whilst adverse publicity board failure of a large publicly expected deal were the most common sources of external weakness.

How are companies managing these risks?

The short answer is that companies are managing quite well the risks of competition and of failed merger and acquisition activity. These are not the risks that most concern the directors, however. The risks that more commonly worry the board of directors tend not to be discussed and are therefore thought to not be managed at all.

The risk of failure to attract sufficient financial resources to enable the company to implement its chosen strategy is usually managed by diligent cash flow, production productivity and cash management controls. However, it is not uncommon, for the staff who are not aware of the underlying strategic imperative to view these controls as an intrusive imposition, rather than as a necessary element of strategic success. Raising awareness of the underlying risk factors that are being managed can lead to greater understanding and better performance.

Many companies, and even those companies whose boards cite government as the largest source of strategic risk, do not have robust systems for monitoring political sentiment, or for ensuring that the policymakers, regulators and legislators are adequately briefed on the potential impact of their actions on the company. A related issue is the reputation of the organisation and the support (or lack thereof) for the company's continued existence and success in its sphere of activities. The public sector, with its strong emphasis on probity and transparency is easily moved to close banks against corporate organisations, whose reputations are tainted, regardless of whether the taint is justified.

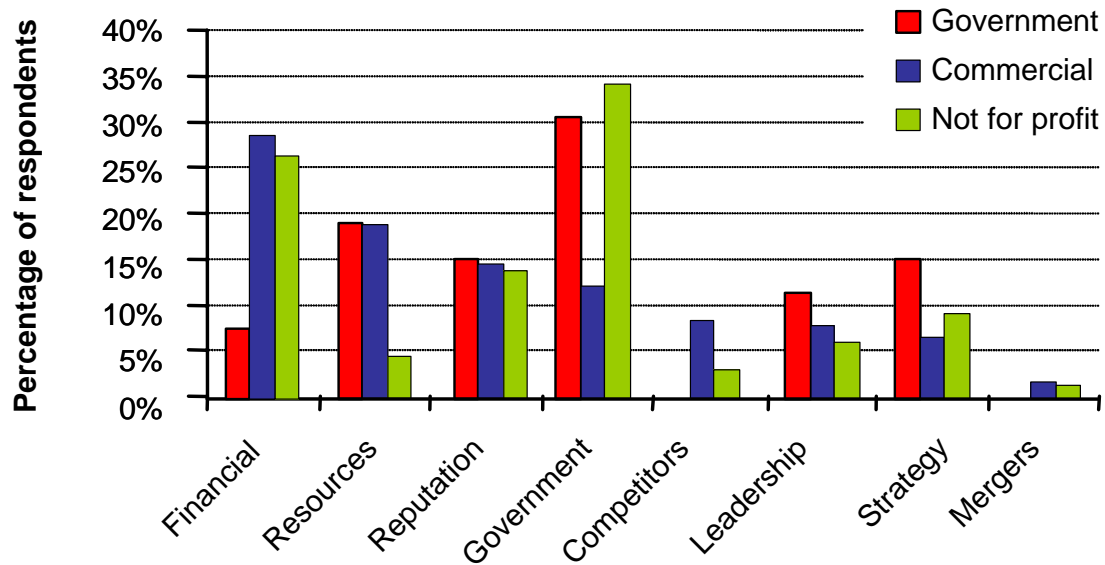
The human resources, including intellectual capacity, of an organisation are not easily subjected to quantifiable analyses. This can lead to their treatment in the risk management system, being superficial and prone to motherhood statements, or, alternatively, to be reduced to the numerical 'productivity side' of the equation, without taking account of the human factors behind it.

The simple observation is that companies do not manage well risks, which are outside of the risk management system, and for which no management plan has been developed, implemented or is being monitored. The issue for the project proponent is how best to raise the issue of what may be an unpalatable source of failure, without becoming personally associated with the issue and risking personal opprobrium. Once the issue is on the table it is much easier to develop a suitable management response. Getting it onto the table requires skill and that is only developed through practice.

Developing appropriate proposals

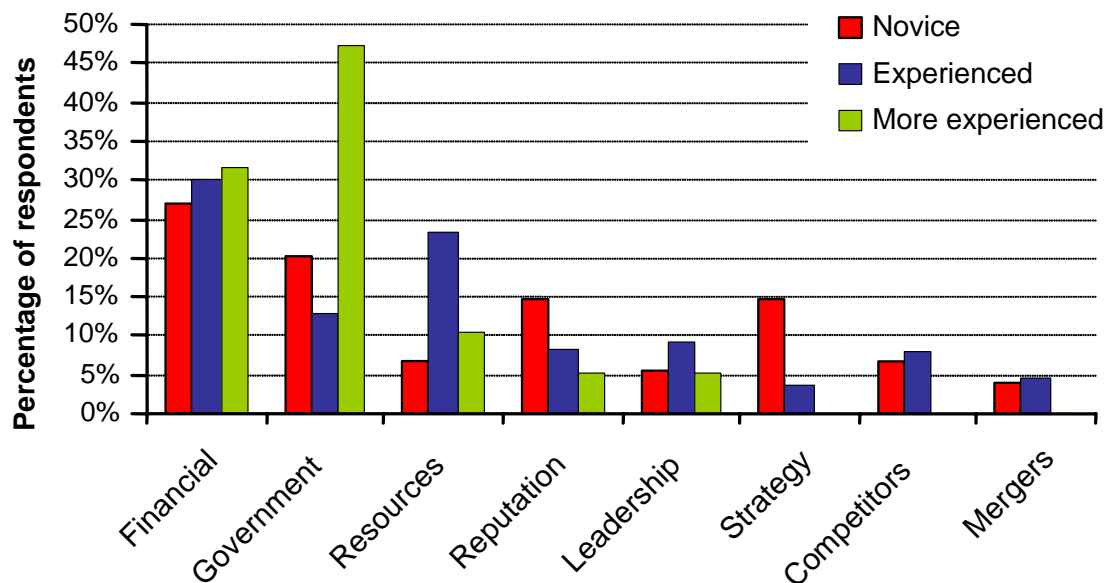
Given the likely risk environment (as perceived by the board) it is important for the project proponent to put forward clear strategies for managing and mitigating the risks, even if they are corporate risks and not likely to fall within the purview of the bank. Common business practice is for proponents to discuss only the financial risks but, for higher proposal success rates, additional elements must be added to the conversation.

It is important to tailor those additional elements to fit the company that is the target of the proposal. Risk is perceived quite differently in different types of organisation.



The successful project proponent will address the risks that are most likely to affect the board being targeted. The risk environment for a large government organisation is very different than that for a large commercial organisation. Addressing the right risks in the right order will engender trust as the board will recognize that they are being addressed by someone who understands their situation.

The perception of risk is also affected by the seniority and experience of the board member concerned. Younger and less experienced board members are more likely to be concerned about financial risks than their more experienced counterparts. They are also more likely to be ‘gung ho’ about M&A activity. Unless they are a founding or executive director, it is possible that a younger, less experienced, director may not be as able to influence the whole board to their way of thinking as an older, more experienced, director.



More experienced directors are more likely to cite the role of government and regulators as a concern and also to be highly focused on the traditional financial risks.

Adjusting the presentation to focus on the likely preconceptions of the directors will allow the presenter to prepare answers for the issues that may be raised and to proactively guide the conversation towards a successful conclusion.

Emerging new risks

When discussing the risks that are most likely to occasion strategic failure the directors in the research made no mention of:

- Ethics or morality
- Sustainability, Environment or CSR
- Fraud or accounts misstatement
- Terrorism or acts of war
- Diversity/group-think
- Tax (or equivalent regime)
- Lack of people willing to be directors

It could well be, that like the risk of financial statements misstating reality, these risks are simply not serious enough to lead to strategic failure, either on their own or in association with one of the other risks. However, it is equally possible, that the lack of reference to these risks is caused by a failure to recognise the devastating potential they entail. Certainly each of these risks has at some stage been the subject of considerable publicity and cause of board is to take on new members who have the skills required to deal with the risk. Only time will tell, which of the risks falls into each of those two categories.

Starting a strategic risk conversation

As was suggested at the start of this document, the current practice of presenting project risk management to boards, or to audit committees, is not gaining the traction and input that boards, management and their professional project managers are hoping generate. It is difficult for a board member, even a qualified, skilled and experienced board member, to do much more than just reflect on how risks are portrayed or query why certain risks have been characterised in certain ways. What is needed is a whole new approach.

To really garner board input, it should be sought at an early enough stage to allow the board to have some ownership of the key risks that will form the basis for monitoring and reporting the project at the board level.

Ideally the board input will be first gathered in a forum where the board members feel able to be candid about the issues that cause them greatest concern. This is not always in the presence of management, other than, perhaps, the CEO. Establishing a forum where board members feel empowered to speak on taboo subjects, such as lack of consensus on the board or lack of management support for the endorsed strategy is difficult.

Gaining access to a board retreat or a special meeting may assist in developing an appropriate forum. To get the most from the board input the forum needs to be firstly an information gathering exercise and also an arena for the development of a shared vocabulary for discussion of the largest risks that threaten strategic attainment and the successful delivery of the project.

Having discovered the key risks as perceived by the board the possible mitigation strategies can be postulated. It is expecting too much for these to be quantified or assessed in any great detail at the same meeting. Much of the work in developing responses will fall to the company staff and not an external project proponent. The aim of the first meeting is to gather information about the board's perceived risks and to delegate to management the task of managing those risks. A second meeting is then required to apprise the board of the results of the detailed evaluation and the resultant portfolio of risks and reporting mechanisms. This is immediately an issue, as access to the board is rarely granted twice in any process. However, if it is sought and granted, the project proposed will have a far greater likelihood of success.

Given a single point of access to the board most professionals opt to present rather than to inquire. However, it is the process of inquiry that opens up the possibility of discussing some new risks, especially if there is a difference in perception between the board and the project management team. Taking the courageous step of using scarce and valuable board time for a process of inquiry is the only way to gain this insight. If there is only one chance to gain board time then that chance should be spent on developing a shared understanding of the risks rather than on presenting the project manager's understanding of the risks.

Once the process has been started through an open inquiry the board can be kept informed by means of written reports or graphic kpis. There is less need for a repeat meeting although, having had a strategic conversation, most boards will find the time for follow on sessions with the project proponent; this is the point at which successful proponents will make the leap from banker to strategic adviser.

Summation

Many project risk management systems fail to identify the risks as perceived by the board, particularly in the case of risks that arise from the board itself, from the senior management team and from government or regulatory actions. These risks are often believed by the board to be the risks most likely to underlie a strategic failure.

By relinquishing the position of an expert presenter and adopting, instead, the position of an inquisitive researcher, the project proponent may gain insights into additional risks that the board believe to be germane to the project given its current corporate strategy. Developing management responses to these risks is not difficult once they are in the system but is impossible when the risks are not openly acknowledged and remain tacit. Being seen by the board as a person who understands the overall corporate context and who can add strategic value is an enhancement to the reputation of even the most technically skilled professional project proponent.

Ready to excel in your Boardroom?



Julie Garland McLellan is one of Australia's leading experts on boards and governance.

Since obtaining her diploma of company directorship in 1996 Julie has served on the boards of listed and unlisted companies in the government, commercial and not-for-profit sectors including MUEF, VENCORP, and Bounty Industries amongst others.

Julie's broad international working experience and her detailed understanding of how vital effective governance is to the success of a company or organisation, provides Board members with a tremendous advantage in making their experience and impact a successful one.

A published author and frequent presenter on governance topics, Julie addresses single boards, company conferences, and training seminars. She also works with project teams to assist in preparing and rehearsing presentations for boards, a confidential service aimed at understanding and managing likely objections on a project-by-project basis.

She also assists aspiring directors and company boards to understand the nuances of the company director role through facilitated governance workshops and her Board Readiness™ and Board Excellence™ programs. Julie specialises in strategy and risk workshops for boards and directors.

Additional information is available at www.mclellan.com.au which includes subscribing to Julie's monthly e-newsletter *The Director's Dilemma*, a publication that uses scenarios to provide insight into the risks and issues that company directors face.

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